Corporate Governance and Accountability for Performance

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I. Introduction

I am pleased to be invited to join my colleagues in a discussion panel at today's conference. I intend to take my recent discussion paper ‘Principles for Core Public Sector Corporate Governance, Applying Principles and Practice of Corporate Governance in Budget Funded Agencies’ which has been circulated to you as a starting point.

I am very pleased to have Michael Carmody and Stephen Skehill with me on the panel. From my perspective in the ANAO they are two of the CEOs in the Australian Public Service (APS) who have for some time been shaping and consolidating robust corporate governance within their agencies. They have approached the challenges their very different agencies present in particular and quite innovative ways. They have an interesting story to tell. I am sure you will find their experience will stimulate useful ideas and approaches to support directions you and your agencies may wish to explore or at least compare to your own experiences.

I am also very pleased to welcome Geoff Applebee, Managing Partner, Canberra, of Ernst and Young. Geoff and his colleagues provided very useful background and comments on the discussion paper. I take this opportunity to thank him publicly. Geoff will be providing a private sector perspective on corporate governance issues.

In this presentation I will focus broadly on the three areas that the program sets out for our panel discussion in a complementary manner to comments by my fellow panellists. However, I propose to take the third item first and provide some background to the preparation of the discussion paper; and then discuss briefly the need for effective corporate governance in the APS. I will spend more time commenting on the accountability framework as a basis for effective corporate governance. In order to minimise possible duplication with my fellow panellists I will concentrate on the most significant issues from an audit rather than a management perspective. This should in no way be taken as a narrow view of the wide ranging ambit and impact of corporate governance not only internally but also externally.

II. Putting Together ‘Applying Principles and Practice of Corporate Governance in Budget Funded Agencies’

The discussion paper you have before you was released at the end of June. The level of interest it has generated has been very pleasing. It has just been reprinted and copies have been provided for today’s seminar. From letters and direct feedback I have received over the last month or so I
understand that agencies are finding it timely and helpful, that it contains constructive ideas that they can put to practical good use. If that is broadly so the efforts made by ANAO staff and many others in a range of agencies and private sector groups are well justified.

I stress that the paper is for discussion. It is not a tabled audit report. It was designed primarily for circulation to senior executives in the APS. My prime objective was to lay out for them some ideas and directions aimed at revitalising public sector governance which have become apparent from our audit activities. As Auditor-General I have a very privileged viewpoint of developments in all Commonwealth agencies as well as access to the audit work of my fellow Auditors-General in all Australian jurisdictions and our equivalents in many other countries. Nothing stands still. The paper is aimed at stimulating better implementation of a robust governance framework and its on-going development by agency management.

I have been very conscious of developments in corporate governance within the private sector, particularly those in recent years in Australian listed companies that have been strongly encouraged by the Australian Stock Exchange requirement that they include information in their annual reports on their corporate governance practice. I was also aware of parallel work being done to focus on corporate governance in statutory authorities and Government corporations such as Telstra and Australia Post. Where I perceived there to be a gap was in core public service awareness of the opportunities provided, for better management performance and accountability, by clearer recognition of the need to integrate effectively the various elements of the governance framework; adapting or adopting better private sector and/or Government corporations’ practice; and looking at how the framework might be applied to support revitalisation of Budget funded agencies in a much more contestable, if not competitive, environment.

I was only too well aware of a number of dilemmas in this approach, as well as a degree of cynicism not just in the public sector and its supporters but also in the private sector. Budget funded agencies have a very different chain of command from that found in a public company, where governance focuses on the respective roles of management, the Board and shareholders and where the bottom-line is shareholder value and corporate returns. Budget funded agencies do not come in a standard size and or a single organisational structure. The nature of organisations and their functions in the APS are very diverse. Agencies have to satisfy a complex range of political, economic and social objectives. They operate according to different external constraints and influences than do public or private businesses. This is particularly evident in their accountability requirements.

The bottom line is often not that well defined in the APS where success is not just a measure of a dollar return on the capital invested. Performance
assessment in the APS covers a range of measures both quantitative and qualitative including being accountable for meeting community service and international obligations, for equity in service delivery and for high standards of ethics. The private sector also is concerned to be a good ‘corporate citizen’ but does not have the same political imperatives in dealing with the Australian community and the demands for openness and transparency.

The range of success factors also reflects, in part, the range of stakeholders in the APS. These include the many service recipients and taxpaying and non-taxpaying citizens and non-citizens. Within this varying mix there is a range of views about suitable performance measures for the various government programs. While many agencies are trying to confine such measures to those that are most relevant to their program performance, inevitably the multiplicity of stakeholders creates pressure for more rather than fewer performance indicators.

As the corporate governance discussion paper points out, another distinguishing feature of FCA agencies particularly, is that authority and accountability for an agency’s management rests solely with the CEO. This is reinforced in the proposed Public Service Act. Any Boards created are therefore more likely to be of an advisory and not a decision-making nature. This varies the focus of responsibility but not the basic principles, discipline or facilitation that good corporate governance can provide for better agency performance.

Nevertheless, it was also very evident that the principles of corporate governance are the same in both public and private sectors. Good corporate governance requires clear definitions of responsibility and a clear understanding of relationships between the organisation’s stakeholders and those entrusted to manage its resources and deliver its outcomes. In a complex operating environment such as is evident in the APS, these requirements become that much more important. Good corporate governance is based on a clear code of ethical behaviour and integrity which is binding on management and staff and communicated to stakeholders. This is also significant in the establishment of sound risk management approaches and the confidence it can give those stakeholders. A robust accountability framework encourages better performance through sound risk management.

I was also well aware that these issues are not by any means new to the APS. In the last decade Budget funded agencies have put in place many of the elements of good governance. These include corporate planning, business planning, audit committees, agency codes of ethics, program management, budget information, identification of stakeholders, performance information and standards, focus on client service, and planned professional development - to name just a few. The real challenge
The discussion paper reflects a shared realisation of these factors. In short, the aim was to develop a general model of corporate governance which could be addressed by Chief Executive Officers (CEOs) and their Senior Executive Service (SES) managers in particular in relation to their own agency. The timing also seemed very apt with the imminent passage of the three bills replacing the Audit Act 1901 and the introduction of the Public Service Bill 1997 replacing the Public Service Act 1922. The new legislation, now all expected to be in place by next year, provides the challenge and opportunity of a quite different administrative and financial framework offering greater management flexibility for more personally oriented accountability for performance. Above all, the discussion paper does not offer a one-size-fits-all prescription for agency management.

The structure of the discussion paper is quite straightforward. It looks first at existing public sector governance structures and how these might fit within a renewed corporate governance framework. It then examines the potential for agencies to strengthen or to establish an Executive Board of Management within existing accountability and reporting structures; how such a Board might operate; and its potential responsibilities and reporting arrangements. It sets out five steps an agency might take towards establishing an effective corporate governance framework. Lastly, it contains a Chief Executive’s Checklist to assist him or her to assess the strengths and weaknesses of their agencies’ current governance framework. The feedback I have received is that the checklist is proving to be very useful and is being circulated around agencies, within and outside the Budget sector, including at Board and governing body levels.

In summary, that is the task we set ourselves. The result is in your hands for you to assess as to its usefulness. I look forward to your feedback and to any questions you might have at the end of this session. I would like to go on now to comment on the need for effective corporate governance in the Australian Public Service.

III. The Need for Effective Corporate Governance in the Australian Public Service

I have already canvassed a number of the important factors putting pressure on all of us to ensure we have in place an effective corporate governance framework in our own agencies. There is also a need for
effective governance arrangements across agencies to address across-portfolio, whole-of-government and private sector service delivery issues so as to enhance public service performance. This is a subject for another time and another day. You are all no doubt well aware of the scale and the pace of change we are all experiencing in the current APS environment. Working with and through this change is a task which draws heavily on our leadership and management structures, re-assessing of priorities, balancing of our resource commitments, developing different skills and rethinking our management information systems. While the negative aspects of change are often most apparent, particularly in sapping of morale and value systems, the onus is very much on us as professional public servants to ensure that the outcomes of change are well communicated, are constructive, work effectively and will add value to program outcomes.

I consider that the adoption of a sound corporate governance approach by agencies can be of great assistance during this period of rapid change, of increasing institutional complexity and of decreasing centralised direction of the APS. These developments are, in turn, adding to the levels of responsibility and accountability of individual APS managers. In this climate the reconstruction and readjustment of agencies is being accompanied by an intensified public scrutiny and increasing levels of accountability. We are urged to look at ways of adopting more private sector type approaches, assess whether activities should be undertaken in the public service, market test, contract out, be more market oriented and even directly competitive. These are not demands that most of us have had to address in our public service careers.

Corporate governance offers an approach by which agencies can mobilise their internal resources to review levels of responsibility and to renew command structures across the organisation. It emphasises the renewal of clear communication and up-to-date information both agency-wide and to all stakeholders. A key aspect of renewed governance is to ensure that all participants are aware of, and accept, their roles, responsibilities and accountabilities and that they have a sound understanding and appreciation of their practical importance in the public interest. The framework is very people oriented involving better communication; a more systematic approach to corporate management; a greater emphasis on corporate values and ethical conduct; risk management; skills development; relationship with citizens as clients; and quality service delivery.

A well governed agency will provide to its CEO and its Minister, to all staff and other stakeholders, reliable, well founded, assurances that it is meeting its performance targets and that all reform agendas are being effectively implemented. Above all, a well governed agency can achieve better performance: it will have the robustness, the internal cohesion and direction essential to successfully drive the organisation forward and to
respond quickly and coherently to external conditions. This must add to both the credibility and confidence all interested parties have in our public institutions. It certainly counteracts the often negative perceptions conveyed in the various media. We need more good news stories even if they are not necessarily regarded as of great interest by the ‘popular’ press.

IV. Corporate Governance and the Accountability Framework

The third and last part of my contribution today focuses on the accountability framework and the contribution corporate governance can make to its effectiveness. As I indicated earlier, I will address mainly those aspects of governance which relate to our audit work and deal primarily with control, assessment and assurance.

The discussion paper identified ways in which an agency’s executive can develop corporate governance to maximise both the performance and conformance of the organisation. I have stressed the advantages of using a corporate governance strategy to improve agency performance. Perhaps more obviously, agency governance can greatly enhance accountability for such performance through establishing effective systems of control. I have no doubt there is considerable interest in how an agency can establish a robust control environment, a subject of great audit interest, and the control structures necessary to support it. I will now address these and related questions.

How do agencies establish an effective control environment?

The notion of a control environment starts from the top of an agency. To be effective it requires clear leadership and commitment. This imperative is reinforced by the interrelationship of risk management strategies with the various elements of the control culture. The control environment of the agency will strongly influence the design and operation of control processes and procedures to mitigate risks and achieve the agency’s objectives. The clear intent and message to staff should be that such processes and procedures should be designed to facilitate rather than to inhibit performance. This approach should be promoted as good management. In short, the control environment is a reflection of management’s commitment and attitude to ensuring well controlled business operations that can demonstrate accountability for performance.

I cannot over-stress the importance of the need to directly integrate the agency’s approach to control with its overall risk management plan in order to determine and prioritise the agency functions and activities that need to
be controlled. Both require similar disciplines and emphasis on a systematic approach involving identification, analysis, assessment and monitoring. Control activities to mitigate risk need to be designed and implemented and relevant information regularly collected and communicated through the organisation. Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively. The achievement of the right balance is important so that the control environment is not unnecessarily restrictive nor encourages risk averse behaviour. To the contrary it should be promoting sound risk management and the systematic approach that goes with it.

**What are the components of a sound control environment?**

The adoption of a sound and robust control environment at the top of an agency will substantially influence the design and operation of control processes and procedures. The following is a description of the key components of a control environment which should lay the foundation for an effective control structure.

Firstly, **control culture and management style.** Management’s integrity and ethical values, preferences, operating philosophy and style greatly influence the control environment. Standards of behaviour and commitment to ethical values are reflected in management’s operating style including recognition of the extent to which control is necessary to effectively govern the entity. These factors strongly influence the achievement of the entity’s objectives and policies and can drive the development and maintenance of effective control structures throughout the agency.

The extent to which the agency achieves its objectives is dependent upon how well it utilises available resources. As a consequence, the effectiveness of an entity’s **planning, budgeting, monitoring and reporting processes** is fundamental to its operations and the overall strength of the control environment.

The **structure of the agency** provides the framework in which activities are planned, executed, controlled and monitored. An entity’s structure reflects the management approach taken, for example, with centralised or devolved authority emphasising the individual or team based approaches. The structure can also be dependent on the agency’s size and the nature of its business activities. The governance structure and accountability processes should result in the appropriate assignment of responsibility within the agency. Individual sign-offs are an important element of the exercise of that responsibility.
The CEO or the governing body of the agency, together with senior management are responsible for devising and maintaining the control structure. In carrying out this responsibility management should review the adequacy of internal controls on a regular basis to ensure that all key controls are operating effectively and are appropriate for achieving corporate goals and objectives. The entity’s executive board, audit committee and internal audit are fundamental to this exercise. Management’s attitude towards risk and enforcement of control procedures strongly influences the control environment.

An effective audit committee has the potential to strengthen the control environment, of which it is part, and assist the governing body foster an appropriate control culture. The Committee’s strength is its demonstrated independence and power to seek explanations and information as well as its understanding of the various accountability relationships and their impact, particularly on financial performance.

Performance monitoring. Agencies need to employ effective procedures to monitor performance, including financial and non-financial aspects of their business activities. Effective procedures for monitoring an agency’s performance is an integral part of maintaining a strong control environment. This pre-supposes that there is a credible performance management system in place including establishment of a performance culture, appropriate measurements, targets and assessments.

The agency’s use of information technology greatly influences the effectiveness of the control structure. It is the responsibility of management to establish a framework for overall control over the use of information technology recognising the need to secure core agency data but with the facility to access it on a corporate wide basis. The absence of integration of many of an agency’s systems puts great pressure on computing and other interfaces to ensure that accountability does not ‘fall down the cracks’.

Human resources. The proper functioning and operation of any control structure is dependent on the competency and ethical standards of the agency’s personnel. The skills, selection and training of the personnel involved and their understanding of controls are probably the most important requirements in establishing and maintaining an effective control environment.

Legislative compliance. The effectiveness of the agency’s systems and procedures for monitoring compliance with applicable legislative requirements, particularly those which govern their activities and financial
management behaviour and accountability, is a fundamental requirement of a sound control environment. As in other management areas, it is important to know how, when and where to seek specialist assistance. This is particularly the case as the APS moves more into an environment of contracting out and partnership arrangements for service delivery.

**External influences** outside the control of the agency can have a direct impact on its operations and business practices. Management need to identify such influences and assess their likely/possible impact so that prompt action can be taken to address them where it is possible and appropriate.

**What are control structures?**

Effective control structures provide a solid and reliable basis for efficient and effective achievement of objectives. They assist the CEO or governing body of an agency to uphold their public sector corporate governance obligations. Control structures should assist with compliance with laws and regulations; minimisation of fraud; corruption and waste; fair and equitable treatment of staff and program recipients; reliable, accurate and timely reporting of financial and administrative performance; and the delivery of efficient and effective agency programs. They may be organisational arrangements, logical systems with in-built checks on decision-making and processes of a manual or computing nature. They may be early warning signals indicating lack of authority, absence of due process, or simply errors. They may be preventative and deny further access or simply shut down. Facilitative structures will indicate what needs to be done. Above all they should include a sound audit trail.

Control structures implemented within an agency should be commensurate with an acceptable level of risk, the nature of the entity and its program delivery. It must be kept in mind though that controls provide reasonable assurance, not absolute assurance that organisational objectives are being achieved. Control is a process, a means to an end, and not an end in itself. It impacts on the whole agency, it is the responsibility of everyone in the agency and is effected by staff at all levels.

The control structure will provide a linkage between the agency's strategic objectives and the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the achievement of the agency’s objectives and which adds value by focusing control efforts on the ‘big picture’.

**What are the tools management can use to achieve effective control structures?**
Given greater responsibility for governing bodies to maintain effective control structures, and to gain assurance to this effect, there is growing need for reliable structures, procedures and practices to support the key elements of public sector corporate governance.

The following structures, procedures and practices can assist public sector managers to discharge their control responsibilities:

- Control Self-Assessment
- Compliance Management
- Delegations of Authority
- Internal Audit
- External Audit
- Audit Committees
- Executive Boards

I will comment briefly on each element of the framework.

**Control self assessment** is a tool allowing governing bodies to promote a controls’ culture within the entity. It is the reporting process where program managers are actively responsible for developing, assessing, maintaining and monitoring controls in their respective areas. This usually involves the completion of self assessment checklists confirming that control processes and procedures are clearly understood, implemented and operating effectively. More recently they have included ‘sign-offs’ for individual responsibility taken.

**Compliance management** is closely related to risk management. For effective compliance management, it is important that the control structure has built in mechanisms to observe legislative compliance, prevent breaches occurring and alert management of the consequences and penalties associated with non-compliance. Effective mechanisms are advisory and facilitative to promote compliance, with checks largely being of an 'exception' nature to minimise unnecessary involvement in processes which can be checked out by other means including built-in, and now generally automated, audit trails.

**Delegations of authority.** Governing bodies need to ensure proper attention to the adequacy and appropriateness of delegations. The proposed new Financial Management and Accountability Act 1997 will encourage CEOs to review existing delegations for their appropriateness.
It is good practice to review delegations regularly taking into account the risk assessment undertaken as well as any feedback from the control mechanisms in place.

Effective delegation of authority provides the linkage between the governing body, management and the individual employees who are responsible for the basis operation of control processes and procedures.

An agency’s internal audit assists in maintaining and refining the control structure by ongoing evaluation of its effectiveness. The agency executive, through an audit committee, should ensure that internal audit coverage includes the whole control structure.

Internal audit plays a significant role in the ongoing monitoring of the effectiveness of the control structure. The key functions of internal audit are to provide assurance that the control structure in place is operational, efficient and effective; to provide assurance that compliance with policy, processes and procedures concerning governance practices, legislation and delegations is upheld; to audit business processes and activities and report on their efficiency and effectiveness; involvement in the design of control activities for systems under development; to undertake special audit assignments at the request of the audit committee or governing body; and to assist the external auditor with the audit of the financial statements predominantly by enabling reliance to be placed on control assurance work.

Given the high expectation of internal audit, there is a need to ensure that its performance is continually monitored. The audit committee has an important role in assessing and improving the performance of internal audit.

Audit Committee. The ANAO Better Practice Guide on ‘Audit Committees’ issued in July 1997 states that ‘an effective committee has the potential to strengthen the control environment (of which it is a part) and assist the governing body fulfil its stewardship, leadership and control responsibilities’.

While the proposed new financial management legislation requires all public sector entities to establish an audit committee, there are sufficient arguments in the benefits themselves to justify the establishment of an effective audit committee. The Audit Committee should oversee internal audit, liaise with external audit and oversight the agency’s control and risk management structures.

In respect of Internal Audit, the Audit Committee should review and endorse the internal audit charter; take an active interest in the
appointment of the head of internal audit and its staff; review and endorse the internal audit strategic plan and annual work program and monitor progress against the plan; review internal audit reports and monitor and critique management’s responses to findings and the extent to which recommendations are implemented.

In respect of External Audit, the Audit Committee should review the proposed audit strategy; review all external audit reports and critically evaluate management’s responses to the findings and the implementation of recommendations; review the financial statement preparation process and consider the appropriateness of accounting policies and disclosures; and review external audit performance, considering independence, objectivity and effectiveness.

Both internal and external audit should work in virtual ‘partnership’ with the Audit Committee to strengthen its role as an effective element not just of the agency’s control structure but also of its corporate governance framework.

In respect of control structures, the Audit Committee should review documentation that supports the ongoing effectiveness of the control structure; review of representations or sign-offs by program managers on matters pertaining to the financial statements process and the control structure supporting that process; and review and monitor compliance with policies in relation to ethics and security, privacy, fraud, conflicts of interest and the handling of sensitive information.

*External audit* has an important role in reviewing and contributing to the agency’s control structure. It must rely on the structure and, accordingly, has to test its robustness and completeness; identify any weaknesses that impact on the adequacy of its financial reporting process and administrative processes; and provide advice and review opportunities for more effective controls. In this way it should be able to contribute to improved effectiveness of the control structure.

**Public Sector Executive Boards** can support the leadership role of the CEO. While the majority of the budget funded entities do not have formal boards of management the discussion paper on ‘Applying Principles and Practice of Corporate Governance in Budget Funded Agencies’ comments on the idea of agencies, where appropriate, establishing executive boards as part of their governance arrangements.

The value of executive boards supporting the leadership role of the chief executive officers can be significant. Effectiveness can be enhanced by sharing and distributing workload and thus enabling more consideration
and independence to be given to important and sensitive matters impacting on the administration and effectiveness of the agency.

An Executive Board can assist the control structure of the agency by establishing and monitoring policies to ensure that the agency complies with the law and confirms with the highest standards of financial and ethical behaviour; by adopting an annual budget for the financial performance of the agency, monitoring the results on a regular basis and ensuring consistency across budgeting, accounting and reporting systems particularly as transition to an accrual basis proceeds; by adopting clearly defined delegations of authority across the agency; and by ensuring that the agency has adequate reporting systems and has a proper control structure in place together with appropriate monitoring of compliance activities.

I have only briefly touched on the issues of Executive Boards and legal compliance and other imperatives for agencies as these will be taken up by my fellow public service panellists.

V. Concluding Remarks

I would like to conclude by assuring you that the ANAO will do whatever it can to provide useful ongoing advice and support in developing a sound corporate governance framework for your agencies. Our financial statement, financial control and performance auditors will work with agencies in this regard. We have produced very useful better practice guides already on relevant topics such as model financial accounts, asset management, accounts processing, audit committees, performance information and the internal audit function. We have also circulated a draft guide with the Management Advisory Board (MAB) dealing with client service delivery.

In the next few weeks I propose to release a Better Practice Framework on Control Structures in the Commonwealth Public Sector. I have drawn on some material from that work for my presentation today. I consider that this publication will also be useful to agencies in helping to improve their performance with more effective systems of control. We are presently considering an initiative for next year to produce an updated better practice guide on internal audit arising from a survey of fifty Commonwealth agencies benchmarked to best international practice. We will be discussing this with agencies to gauge the degree of interest in what could be a very useful exercise for all concerned, including those not involved but which would benefit from identification of better practice.
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We look forward to improving our support to you. We welcome your feedback and dialogue with us on any of the foregoing topics. Thanks again to all those who responded to the initial drafts of the discussion paper. Your comments were very helpful. Subsequent comments will also be useful in further discussions of the issues and any subsequent updating of the paper.